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TAGS: ECON EAGR EAIR ECPS EFIN EINV EMIN ENRG EPET ETRD
BEXP, KBIO, KIPR, KWMN, IN
SUBJECT: INDIA'S ECONOMIC SURVEY FOCUSES ON GROWTH AND FISCAL
CONSOLIDATION, AHEAD OF BUDGET

¶1. (U) Summary: The Economic Survey for India's Fiscal Year (IFY) 2008-09 (4/1/2008 to 3/31/2009) presented by Finance Minister Pranab Mukherjee in India's Parliament on July 2 paints a resilient picture of the Indian economy. The Survey sees a 'U shaped' recovery for growth in IFY 2009-10 (4/1/2009 to 3/31/2010) with GDP growth to be as high as 7.75%, if the global economy turns up by September 2009, and a reasonable growth of 6.25% if the global recession drags on. The survey proposes an ambitious list of reform measures - some of which have been suggested in the past - including a 49% foreign direct investment (FDI) cap in insurance, allowing "multi-format" retail starting with food retail, and restructuring expensive subsidies. Some of these measures were announced in the Budget Speech given by Finance Minister Pranab Mukherjee on July 6 (more in detail septel). End Summary.

India's Growth Revival

¶2. (U) India's Economic Survey for IFY 2008-09, presented by Finance Minister Pranab Mukherjee in Parliament on July 2, states that the Indian economy withstood the adverse global conditions and grew by 6.7% in IFY 2008-09 versus 9.0% IFY 2007-08. Agriculture growth moderated to 1.6% in IFY 2008-09 from 4.9% in the previous year, mainly on account of the high base effect. Industry grew by 2.4% in IFY 2008-09 versus 8.5% in IFY 2007-08, led by weaker exports and lower domestic demand. Even so, India continues to retain its position as a preferred destination for foreign investments. Foreign direct investment (FDI) flows to India grew 85% in 2008 to US$46.5 billion from US$25.1 billion in 2007. On the back of a narrowing trade deficit as well as continued resilience in remittance flows, the Survey expects a current account surplus of 0.3% to 2.8% of GDP in IFY 2009-10, assuming crude prices of US$70-80 per barrel.

¶3. (U) The Survey asserts that reviving growth is the key priority for ensuring inclusive growth and generating revenues needed for meeting the social welfare objectives. The Survey forecasts real GDP for IFY 2009-10 to reach between 6.25% to -7.75%. The speed with which the Indian economy returns to a high growth path depends on the revival of the global economy, particularly the U.S. economy and the GOI's ability to push policy reforms. In the event of a more prolonged external economic downturn, with the revival of the global economy/US economy being delayed until 2010, the Survey

projects that Indian growth would moderate to the lower end of the range. The economy is poised for a U-shaped recovery, with the last two quarters of FY 2008-09 (October 2008-March 2009) and the first two quarters of FY 2009-10 (April-September 2009) forming a trough. The Survey assumes a normal monsoon, leading to 3% growth in the farm sector. The Survey highlights underlying domestic strengths - including the high contribution of services, strong rural incomes, and a rising savings rate, thrust for infrastructure, and buoyancy in foreign direct investment - as key factors supporting growth.

Fiscal Consolidation

¶4. (U) India's fiscal deficit for IFY 2008-09 slipped sharply to 6.7% of GDP in IFY 2008-09 from the budget target of 2.5%. The slippage was largely due to falling revenues, implementation of the Sixth Pay Commission Award, the Agriculture Debt Relief Scheme, as well as to the stimulus packages announced between December 2008 and February 2009. The Survey emphasizes that the GOI should announce reform measures to restore the Center's fiscal deficit to 3% of GDP as per the Fiscal Responsibility and Budget Management Act target. Tax and expenditure policies need to be restructured for improving fiscal transparency to achieve fiscal consolidation. It calls for the abolishment of the fringe benefit tax, securities transaction tax and the commodities transaction tax. The Survey encourages the government to introduce a new Income Tax Code, as well as implement the Goods and Service Tax (GST) by April 2010.

¶5. (U) The Survey stresses 'revitalizing' the disinvestment program to generate Rs 250 billion (roughly US$5 billion) per year as a feasible way to lower the deficit. Other fiscal measures which the

Survey says could reduce the fiscal deficit include streamlining oil, food and fertilizer subsidies to reduce leakages and the possibility of direct cash transfers to targeted groups. The Survey suggests that a new cooking gas subsidy of a maximum of 6-8 cylinders per annum per household should be given and that the kerosene supply-subsidy should be phased out by ensuring that every rural household (without electricity and cooking gas connection) has a solar cooker and solar lantern. Further, the Survey recommends converting the fertilizer subsidy from a part-producer subsidy to a wholly farmer-user nutrient related subsidy, with freedom for producers to set prices of formulations with different mixes of nutrients.

Inflation Still a Concern

¶6. (U) Wholesale price index (WPI) inflation was very high for much of last year, peaking at nearly 13% in August 2008, followed by sharp falls after that. The average annual WPI inflation for the year ending March 31, 2009 was 8.4%. WPI inflation is currently in the negative territory, having fallen to -0.13% for the week ended June 20. On the other hand, the consumer price index (CPI) continues to remain high (8.6% in May 2009), largely due to food price pressures. The food group has a high weight of 46% in the CPI for industrial workers and 69% in the CPI for agricultural workers. The Survey points out that the supply chain is unable to cope with accelerating growth in income and consumer demand and it has raised concerns of another inflationary cycle. The Survey suggests that the government should increase production of food items to increase supply and reduce food inflation. The discrepancy between the CPI and WPI could be resolved by land and real-estate sector reforms, strengthening the public transport system, building food supply chains and an updated WPI.

Call for Reforms

¶7. (U) The survey calls for wide ranging reforms to boost investments and revive industrial growth. Some of the new reforms include allowing for private sector entry into coal mining and an amendment to the Atomic Energy Act permitting foreign participation in the nuclear power sector. The Survey advocates FDI in retail, calling for FDI in "multi-format" retailing, especially food

retailing, where foreign investment can help create cold supply chains. It also supports raising the FDI cap in defense, insurance and banking sectors. The Survey suggests early passage of the Pensions Fund Regulatory and Development Authority bill for giving statutory power to the regulator as well as liberalization of the spot and futures currency markets of India.

Comment

¶8. (U) Much like last year, the Economic Survey has outlined a number of encouraging, even ambitious, reform initiatives. Also like last year, implementation is key. As a precursor to the introduction of the budget, the Survey has sketched reasonable growth expectations and emphasized the need for reforms across government delivery of services. It acknowledges that the country's growth in recent years has benefited from a benign global economy. Now that global growth is forecast to shrink, India can no longer afford to delay improvements in education, health, efficient subsidy delivery, and infrastructure. The Survey, a product of the Ministry of Finance, spells that out and the reforms needed to return India to its potential high growth path. It remains to be seen whether there is sufficient agreement within the UPA coalition to enact these reforms.

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